

Comment on ESMA's Review of EMIR-Reporting

Complexity of the reporting regime
should be decreased

General Remarks

Deutsches Aktieninstitut¹ welcomes the opportunity to comment on ESMA's consultation regarding the reporting requirements under EMIR.

We represent the view of non-financial companies using derivatives almost exclusively for risk-mitigating purposes. These companies have in general made the experience that both, the implementation of and the day-to-day compliance with EMIR reporting requirements have caused a massive additional administrative burden. Therefore, further steps regarding the reporting obligations should aim at decreasing the burden for the reporting entities wherever possible without putting at risk the regulatory rationale behind EMIR.

ESMA correctly states that experience with the reporting obligations gained so far has revealed several limitations and shortcomings. One of the main shortcomings is that mismatch quotas at the level of trade repositories are considerably high. Nevertheless, we are concerned that the clarifications, adaptations and amendments proposed by ESMA in the consultation paper will increase the administrative burden for market participants even further because significant changes of existing processes will be necessary to ensure compliance with the new proposals.

Furthermore, we are not of the opinion that the ESMA consultation will solve the problem of mismatches which is mainly caused by the requirement that both counterparties have to report the same transaction. In addition, mismatch of reports are also the result of complex reporting requirements that are prone to interpretations. This makes it difficult for market participants to report in a concise manner. Mismatches are the logic consequence. This problem should be addressed by ESMA.

Take for example FX trades. So far it is still unclear which currency has to be filled in the field "notional amount 1" and "notional amount 2". Another example is the reporting of commodity trades. The section "non-precious metals" does not provide for the option to fill in an ISO-code. Therefore, it is impossible for counterparties to gain clarity about the metal which is the underlying of the contract. Furthermore, some derivatives like exotic options cannot be reported adequately as there is no adequate field available to represent the trade correctly. Examples would be so-called barrier options, double barrier options, and touch rebate options. There is

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only one field for a strike price, no fields for barrier or knock-out-events and how the barrier is calculated (e.g. American, European, Bermudian option models). Although somewhat more exotic than standard options, these products are not only used among financial market participants, but also in hedging operations done by non-financial end-users.

In order to solve the problem of different understandings of the reporting requirements trade repositories provide their own clarifications. The result is that details of the required reports differ by trade repositories. E.g. regarding the reporting field “action type” trade repositories like DTCC require market participants to fill in three different fields. In addition, trade repositories like DTCC require FX swaps to be reported as two trades (FX spot and FX forward or FX forward and FX forward) and others, e.g. Regis TR, provide the possibility to report FX swaps as one trade. Therefore, matching reports from different trade repositories is at least a challenging task, or – as the case of the different swap reporting shows – a “mission impossible”.

The problem is aggravated by the fact that it is very difficult for market participants to reproduce why mismatches occurred. In certain cases trade repositories offer only the possibility to download a standard report which does not include every item that has to be reported. It also happens that in these standard reports, which are regularly provided as an excel spreadsheet, the UTI is cut off and/or not comprehensively displayed in the files (e.g. the last digits are lacking).

These are just a few examples for the difficulties market participants face in their best efforts to comply with the EMIR reporting rules. ESMA should take these shortcomings appropriately into account and should draw the right conclusions. In order to avoid misunderstandings resulting in mismatches and to allow counterparties to report concisely, the complexity of the requirements should be reduced. Reporting should not be taken as “l’art pour l’art”. ESMA should rather provide a comprehensible reasoning why the large number of reporting fields is needed for supervisory purposes, and, as a consequence, reduce that very number. An “information overflow” must be avoided by taking out non-critical fields.

To achieve a well-balanced reporting regime which reasonably supports supervisory purposes while at the same time does not overstretch capacities of market participants especially of non-financial companies we recommend the following:

- **Provide more legal certainty:**
Details of the reporting requirements are changing frequently due to updated Q&A of ESMA. These updates require permanent changes of reporting processes on the level of trade repositories and on the level of the reporting entity. One example: ESMA released a clarification in its Q&A regarding the application of the Unique Trade Identifier (UTI) two days before the obligation came into force to assign an UTI to every trade.

At this point in time market participants had already implemented processes for their EMIR compliance and thus were forced to adapt the updated requirements within only two days. This was a very if not too short a time span. Therefore, we ask ESMA to decrease the frequency of Q&A updates or to clarify that companies have to comply with the updates within an appropriate time frame, e.g. 3 month.

- **Decrease complexity:**

As mentioned above, reporting requirements are very complex. Therefore, every reporting field should be carefully evaluated whether it is needed to execute supervisory powers. Good examples for fields which do not seem reasonable are the execution and the confirmation time stamps. It is close to impossible that both counterparties will agree on a common execution time stamp for trades bilaterally agreed via phone, e-mail etc. as the trade is recorded in the systems of the respective counterparties at different times. Therefore, time stamps assigned by the counterparties will hardly ever be matching. The same holds true for the confirmation time stamp as it is common practice among non-financial companies to exchange confirmation forms. Each counterparty reconciles the documents regarding the agreed trade details after receipt. As the confirmation documents are not sent out at the same time, it is impossible to agree on a common time stamp without additional coordination efforts. In sum, the additional administrative burden to agree on a “fictional” execution and confirmation time stamp is not reasonable. It further does not add meaningful information for supervisory purposes, as the agreed time stamps will not necessarily reflect the exact date of the confirmation or the execution for the reasons described above. Both fields should be deleted. In order to match information regarding one and the same trade delivered by both counterparties, the time stamp is not necessary as the UTI is created to solve this identification problem. Therefore, time stamps are of no benefit in this regard and should be abolished. At the very least, it should be sufficient that both counterparties report the day of the execution instead of agreeing on the exact second.

- **Prospective modifications of the existing reporting regime:**

We are well aware that ESMA is not legally empowered to modify the existing legislation. Nevertheless and against the background of the forthcoming evaluation of EMIR, we would like to draw ESMA’s attention to some potential modifications which would help to decrease complexity of reporting, to improve the volume of matching trades on trade repository level and, hence, to improve quality of data.

Mismatches are – as explained above – the result of two reporting entities delivering different reports regarding one and the same trade.

Therefore, counterparties should be allowed to agree that only one

counterparty reports the trade data. This should not be misunderstood as or confused with the possibility of delegation under the current legislation. The delegation does not help very much because both counterparties are still liable for the correctness of the data. Liability should be limited to the reporting counterparty.

In addition, delegation is not used by many corporates as they are obliged to report intra-group transactions anyway. These transactions between the parent company and its subsidiaries do not involve an external counterparty which could be mandated to report. Therefore, as the respective infrastructure is available, especially larger companies do not make use of the right of delegation for external transactions but report for their own. Nevertheless, the legislator and supervisory authorities should be aware that intra-group transactions simply redistribute positions internally and do not increase the overall risk of the group as the risks are compensating each other at group level: Potential losses of one group member are potential gains of another. Due to this “risk neutrality” the information gathered by the reporting of intra-group transactions is of no benefit for supervisory purposes. **Therefore, reporting of intra-group transactions should be abandoned, at least for intra-group transactions executed by non-financial companies not exceeding the clearing thresholds as these transactions are not regarded as systemically relevant in any case.** This would also provide a level playing field with corporates in the US because the Dodd-Frank-Act does not require the reporting of intra-group transactions.

Our Answers to Selected Questions

Q1: Do you envisage any difficulties with removing the ‘other’ category from derivative class and type descriptions in Articles 4(3)(a) and 4(3)(b) of ITS 1247/2012? If so, what additional derivative class(es) and type(s) would need to be included? Please elaborate.

Yes. Market participants sometimes have difficulties to agree on a specific derivative class or type. Obviously, not every derivative can be meaningfully classified in the categories given. For these derivatives the flexibility of a category “other derivatives” should be preserved.

Q2: Do you think the clarifications introduced in this section adequately reflect the derivatives market and will help improve the data quality of reports? Will the proposed changes cause significant new difficulties? Please elaborate.

We refer to the clarification in item no. 25 regarding swaps. The clarification on p. 39 takes only into account the case fixed rate/fixed rate. Therefore, it is still unclear how to deal with the cases floating rate/floating rate or fixed rate/floating rate.

Furthermore, as mentioned in our introductory remarks above reporting to trade repositories differ. Regarding FX swaps reports delivered to DTCC require the reporting of two trades (e.g. FX spot and FX forward). Trade repositories like Regis TR are leaving market participants the option to treat FX swaps as one transaction. Therefore, matching of these trades across different trade repositories is impossible.

Q4: Do you think the adaptations illustrated in this section adequately reflect the derivatives market and will help improve the data quality of reports? Will the proposed changes cause significant new difficulties? Please elaborate.

Item no. 29 states that counterparties should be identified solely on the basis of a Legal Entity Identifier (LEI). Alternative identifiers like BIC or client codes will not be permitted in the future.

We doubt that this proposal will be feasible in practice. ESMA should be aware that it might currently take up to four weeks to receive a LEI. With the deletion of other identifiers new problems will be arising, e.g. with intra-group transactions. Imagine a subsidiary of a group which has not yet been involved in any external derivative transactions, and will never be due to internal guidelines requiring it to act via the centralised treasury unit. If this subsidiary has to hedge a commercial activity for

the first time, a derivative will be provided by the central treasury of the group which then will have to be reported t+1 *including* a LEI. This LEI will never be available in due time as the respective registration process takes much longer than t+1. For these cases reporting including a LEI is not possible. Therefore, ESMA should allow the reporting of either the LEI of the parent company, or the use of an internal number. In addition, this example clearly demonstrates the general problems of intra-group transaction reports and supports our arguments above to abandon this duty.

In addition, the expansion of the field „corporate sector“ to non-financial companies proposed in items no. 31 and 46 increases complexity of reporting and is prone to misunderstandings leading to mismatches of the reported transactions. In many cases corporates activities are diversified and could be categorised in different sectors. The same holds true for intra-group transactions which have to be reported as well. It is very difficult to define the relevant corporate sector for each local subsidiary as they are often active in several business fields. Therefore, both counterparties would have to agree on a “common” sector which would increase coordination work in order to report consistently. Furthermore, we do not see a compelling reason for supervisory purposes to gain knowledge of the non-financial companies’ sector.

Q5: Do you think the introduction of new values and fields adequately reflect the derivatives market and will help improve the data quality of reports? Will the proposed changes cause significant new difficulties? Please elaborate.

Regarding item no. 46 please refer to our answer to Q4. Furthermore, we do not agree that the additional information required by item no. 45 (“country code”) is necessary. Even worse, it would surely increase complexity of reporting. The country domiciliation is part of the Legal Entity Identifier and hence already included in the reporting scheme (“ID of the other counterparty”). Thus, the “country code” would simply lead to a duplication of information.

Regarding item no. 51 it is noteworthy that the introduction of a new field “actual notional” is not useful in all cases. Take for example an amortizing trade, e.g. an interest rate swap. It is impossible to deliver the redemption information in the current set of fields. Nevertheless, to introduce a new field which declares the actual (reduced) notional is not the solution. As such notional changes often depend on floating indices, some of these transactions amortize monthly, quarterly or yearly. As a result such transactions have frequently changing notional values. The update of these trades on a regular basis would require a modification message. However, in our opinion there have not been any changes of financial data after execution and therefore a modification is not the correct message type. Therefore, reporting of “actual notional” should properly take these obstacles into account.

Q7: Do you anticipate any difficulties with populating the corporate sector of the reporting counterparty field for non-financials as described in paragraph 42? Please elaborate.

Please refer to our answer to Q4.

Q8: Do you envisage any difficulties with the approach described in paragraph 45 for the identification of indices and baskets? Please elaborate and specify what would be the most practical and industry consistent way to identify indices and baskets.

ESMA should clarify what is supposed to be labelled an index or a basket. Is there a global list which includes all indices/baskets? What is about OTC derivatives based on reference indices (e.g. Euribor, Libor, or Commodities listed on the LME/CME). We are unsure about how to fill the underlying fields in cases like these.

Q9: Do you think the introduction of the dedicated section on Credit Derivatives will allow to adequately reflect details of the relevant contracts? Please elaborate.

We agree that the relevant key information is adequately covered in the new credit derivatives section.

Q10: The current approach to reporting means that strategies such as straddles cannot usually be reported on a single report but instead have to be decomposed and reported as multiple derivative contracts. This is believed to cause difficulties reconciling the reports with firms' internal systems and also difficulties in reporting valuations where the market price may reflect the strategy rather than the individual components. Would it be valuable to allow for strategies to be reported directly as single reports? If so, how should this be achieved? For example, would additional values in the Option Type field (Current Table 2 Field 55) achieve this or would other changes also be needed? What sorts of strategies could and should be identified in this sort of way?

This problem is often not due to the execution of the trade, but to different treasury management systems used by counterparties which trigger the reporting of the trades. Some systems can reflect trading strategies in a single transaction, while others have to split the strategy into different trades. Therefore, in order to match these trades the possibility to report trading strategies cannot solve the technical obstacle to properly reflect trading strategies in the specific treasury management system.

Q11: Do you think that clarifying notional in the following way would add clarity and would be sufficient to report the main types of derivatives: [...]

Please refer to our comments on Q5 regarding the challenges around redemption payments.

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